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An Analysis of Bank Defenses to Check Forgery And Alteration Claims under Uniform Commercial Code Articles 3 and 4: Claimants' Negligence and Failure to Give Notice

JOHN W. HINCHEY*

In addressing the dual issues of check forgeries and alteration claims faced by many banks, the Uniform Commercial Code sets forth a system of rights and obligations to remedy these problems. In addition, Articles Three and Four also present an array of bank defenses, the availability of which are largely determined by the bank's position in this system. In this article, the author analyzes the inconsistencies and uncertainties inherent in this framework, and determines that there is much room for creativity on the part of banker's counsel in this area.

I. INTRODUCTION: HOW THE U.C.C. ALLOCATES FORGERY AND ALTERATION LOSSES

A. *Three Classic Cases*

There are three classic cases in which check forgeries or alterations typically result in claims against banks. These include instances of forged drawer's signatures, forged endorsements, and

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material alterations.¹

If a forgery² or material alteration³ is discovered prior to the payor bank's final payment,⁴ the item is "bounced" or returned through the chain of holders to the wrongdoer, or, most likely, to the party who took the item from the wrongdoer.⁵ In such an event, either the wrongdoer may be compelled to pay the item, or the party taking the item from the wrongdoer must suffer the loss. If, however, the forged or altered item is finally paid, varying rights and duties are created, depending upon which of the three typical cases mentioned above is involved.

In the case of a forged drawer's signature, the drawer will generally demand that the drawee bank recredit his account because of the improper payment.⁶ Because the drawee bank has already

1. J. BAILEY, *BRADY ON BANK CHECKS* (5th Ed., 1979), states that checks which are altered, forged, or which bear forged endorsements, "are the kinds of problems that land in court most frequently." *Id.* at 22-23.

2. The term "forgery" is not defined in the Uniform Commercial Code (U.C.C.), but is included within the Code's definition of an "unauthorized signature," i.e., "one made . . . without actual, implied or apparent authority. . . ." U.C.C. § 1-201(43). The elements of a forgery have been held to be: a.) a false making or alteration of a written instrument with b.) a fraudulent intent c.) on a document which, if genuine, would have had some legal efficacy or created legal rights or duties. *See State v. Liberty Nat'l Bank & Trust Co.*, 414 P.2d 281 (Okla. 1966).

3. A material alteration is defined in the Code as:

Any alteration of an instrument which changes the contract of any party thereto in any material respect, including any such change in (a) the number or relations of the parties; of (b) an incomplete instrument, by completing it otherwise than as authorized; or (c) the writing as signed, by adding to it or by removing any part of it.

U.C.C. § 3-407(1). All citations or references in this article to "the Code" or "U.C.C." are to the *Uniform Commercial Code, 1972 Official Text, with Comments*, published by West Publishing Company.

4. As defined in U.C.C. § 4-213(1) A.L.I. *Uniform Commercial Code* (West 1972).

5. The Code rationale is that if the drawer's signature is forged, he cannot be liable on the instrument in the absence of negligence or ratification. U.C.C. § 3-401(1); *see id.* § 3-404; *see also id.* § 3-406. If there is a material alteration, the drawer is discharged to the extent that the item has been raised in amount. U.C.C. § 3-407. If there is a forged endorsement, the possessor of the instrument takes no better title than the forger or thief and, thus, cannot qualify as a "holder" in order to enforce the instrument against the drawer. U.C.C. § 1-201(20); *see id.* § 3-201(1); *id.* § 3-301; *id.* § 3-404. Consequently, any provisional settlements along the collection chain will be revoked, thus leaving the loss upon the shoulders of the forger's immediate transferee. U.C.C. § 3-414; *see id.* § 3-417; *id.* § 4-201; *id.* § 4-301; *id.* § 4-303. *See CLARK & SQUILLANTE, THE LAW OF BANK DEPOSITS, COLLECTIONS AND CREDIT CARDS*, 133-34 (1970).

6. Under the Code, the drawer cannot be liable since his valid signature does not appear on the instrument. U.C.C. § 3-401(1). Nor can the drawer bank charge the drawer's account, since a forged signature is not "properly payable" under U.C.C. § 4-401(1). Another basis for the drawee bank's liability to the drawer is said to lie in their contractual relationship; there is an express or implied agreement between the drawee bank and the depositor that the bank will only charge the depositor's account according to his order. *See, e.g., White v. Georgia R.R.*

made final payment,⁷ it cannot recover from prior parties to the instrument, except from: a.) the wrongdoer;⁸ b.) one who received payment with knowledge of the wrong;⁹ or c.) a non-Holder In Due Course (HIDC) who still holds proceeds from the item.¹⁰ Nevertheless, the drawee bank will generally suffer the loss.¹¹

When a forged endorsement occurs, either the drawer or payee may have a cause of action against the drawee bank for improper payment.¹² The drawee bank, however, may then state a claim against prior parties to the instrument for breach of warranties.¹³ Alternatively, some cases have held that to avoid a duplicity of action, either the drawer or payee may claim directly against the depository or collecting bank.¹⁴

Bank & Trust Co., 30 S.E.2d 118 (Ga. App. 1944); *Coffin v. Fidelity-Philadelphia Trust Co.*, 97 A.2d 857 (Pa., 1953). If the bank pays an instrument with a forged signature, contrary to the depositor's order or without his authority, the bank is said to have paid from its own funds, rather than from the depositor's account. *Kares Constr. Co. v. Associates Discount Corp.*, 163 N.E.2d 913 (Ohio App. 1960); *Central Nat'l Bank v. First & Merchants Nat'l Bank*, 171 Va. 289, 198 S.E. 883 (1938).

7. U.C.C. § 3-418.

8. The forger's signature would operate to bind him. U.C.C. § 3-404(1). For example, this liability is usually of little value since he will typically be unavailable or otherwise "judgment proof."

9. Pursuant to the warranties given by prior parties under U.C.C. § 3-417(1)(b), and U.C.C. § 4-207(1)(b).

10. For example, if the party still holds proceeds, he presumably has not paid "value" for the item or has not otherwise "changed his position in reliance on the payment." Thus, the exceptions to U.C.C. § 3-418 would apply.

11. This result is based on the doctrine first established in *Price v. Neal*, 97 Eng. Rep. 871, 3 Burr. 1354 (1762) and carried forward into the Negotiable Instruments Law (NIL). BEUTEL, BRANNAN'S NEGOTIABLE INSTRUMENTS LAW, § 62 (6th ed. 1938). The "final payment" rule has been resisted and strongly criticized by such scholars as White & Summers. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE, 519-29 (1972).

12. With respect to the drawer, the item is not "properly payable" under U.C.C. § 4-401(1) and thus cannot be charged to his account. See *supra* note 6. The payee's right against the drawee bank lies in conversion, as codified in U.C.C. § 3-419(1)(c).

13. U.C.C. § 3-417(1)(2); see also *id.* § 4-207(1)(2).

14. Cases allowing a direct action by the drawer against a depository or collecting bank are: *Allied Concord Financial Corp. v. Bank of America*, 275 Cal. App. 2d 1, 80 Cal. Rptr. 622 (1969); *International Industries, Inc. v. Island State Bank*, 458 F. Supp. 886 (D. Tex. 1971); *Insurance Co. of N. America v. Atlas Supply Co.*, 121 Ga. App. 1, 172 S.E.2d 632 (1970); *Insurance Co. of North America v. Purdue Nat'l Bank of Lafayette*, 401 N.E.2d 708 (Ind. App. 1980); *Underpinning & Foundation Constructors, Inc. v. Chase Manhattan Bank*, 414 N.Y.S.2d 298 (1979). However, there is still a split of authority. See, e.g., *Stone & Webster Eng'g Corp. v. First Nat'l Bank & Trust Co. of Greenfield*, 184 N.E.2d 358 (Mass. 1962); and *Brighton, Inc. v. Colonial First Nat'l Bank*, 176 N.J. Super. 101, 422 A.2d 433 (1980).

For cases allowing a payee whose endorsement was forged to bring a direct ac-

Generally, in a case of a material alteration, the drawer's liability on an altered item is restricted to its original terms. To the extent that the drawer's bank account has been debited due to a material alteration, the drawer may demand that the drawee bank recredit his account.¹⁵ The drawee bank, in turn, may seek recovery from prior transferors of the altered check for breach of warranties.¹⁶ As in the case of forged endorsements, at least one court has held that the aggrieved drawer may seek relief directly from the depository or collecting bank.¹⁷

B. Bank Defenses

The pattern of rights outlined above includes possible claims against banks in the case of forged or altered checks. These claims are subject to the defenses articulated by the Uniform Commercial Code which may be available to a defendant bank.

Section 3-404 of the Code states that an unauthorized signature or forgery is binding on the claimant if he "ratifies it or is precluded from denying it. . . ." This section has a "catch-all" effect which incorporates not only the defense of ratification,¹⁸ but also the defenses of apparent authority (usually granted to a non-agent by careless conduct of the principal),¹⁹ estoppel,²⁰ negligence of various types,²¹ and failure to give timely notice of the forgery.²²

tion, *see* *Ervin v. Dauphin Deposit Trust Co.*, 3 U.C.C. Rep. Serv. 311 (Pa. 1965); *Cooper v. Union Bank*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1 (1973); *Salsman v. National Community Bank*, 102 N.J. Super. 482, 246 A.2d 162 (1968), *Citizens State Bank v. National Surety Corp.*, 612 P.2d 70 (Colo. 1980). Although the majority of decisions have allowed such a direct action by the payee, a number of courts have continued to apply the literal provisions of U.C.C. § 3-419(3) and have denied such a cause of action. *See, e.g.*, *Messeroff v. Kantor*, 261 So. 2d 553 (1972); and *Gillen v. Maryland Nat'l Bank*, 274 Md. 96, 333 A.2d 329 (1975).

15. U.C.C. § 4-401(2)(a). For pre-Code cases discussing this principle, *see, e.g.*, *First State Bank of Lyford v. Parker*, 27 S.W.2d 279 (Tex. Civ. App. 1930); *State Nat'l Bank v. Lark*, 134 Ark. 432, 204 S.W. 101 (1918).

16. U.C.C. § 3-417(1)(c); *see also id.* § 3-417; *id.* § 4-207(1)(c); *id.* § 4-207(2)(c).

17. *Sun'n Sand, Inc. v. United Cal. Bank*, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978). However, there is contrary authority; *see, e.g.*, *Gregory-Salisbury Metal Products, Inc. v. Whitney Nat'l Bank of New Orleans*, 160 So. 2d 813 (La. App. 1964).

18. *See*, Annot., 93 A.L.R.3d 967 (1979) on what acts may constitute ratification of forged or unauthorized signatures under U.C.C. § 3-404.

19. U.C.C. § 3-403(1); *see also*, *Senate Motors, Inc. v. Indus. Bank of Washington*, 9 U.C.C. Rep. Serv. 387 (D.C. Sup. Ct. 1971).

20. *See, e.g.*, 11 Am. Jur. Release § 789 (1963).

21. *See* U.C.C. § 3-406; *see also id.* § 4-406. *See infra* Sections II-IV and accompanying discussion.

22. *See infra* section V discussing U.C.C. § 4-406(a). *See also* U.C.C. § 4-207(4), which provides that "[U]nless a claim for breach of warranty under this section is made within a reasonable time after the person claiming learns of the breach, the person liable is discharged to the extent of any loss caused by the delay in making claim."

The situation where a drawer issues a check to an imposter or "fictitious payee" is addressed by section 3-405. Essentially, the section presumes the drawer's negligence in his not taking greater care to confirm the payee's identity.²³ Additionally, notwithstanding contributory negligence on the part of the bank, this section appears to provide a complete defense.²⁴ To avoid incurring liability, the bank must have acted in good faith,²⁵ and some cases have interpreted the section as requiring that the bank must have acted without negligence, in accordance with "reasonable commercial standards."²⁶

Section 3-419(3) would seem to limit the liability of a depository or collecting bank to "any proceeds remaining in [its] hands" if it acts "in good faith and in accordance with the reasonable commercial standards" applicable to the banking industry.²⁷ However, this apparent protection is rendered somewhat illusory since the depository or collecting bank is subject to full liability pursuant to its warranties.²⁸ Thus, many jurisdictions have simply ignored, or refused to apply the section in allowing a direct action against the banks by the payee.²⁹

As provided in section 3-406, negligence contributing to the making of a forgery or alteration is a defense in favor of an HIDC, drawee, or "other payor." Although a drawee bank may raise this defense, difficult questions, resulting in divergent authority, have

23. U.C.C. § 3-405 comment 4; 1 ANDERSON, UNIFORM COMMERCIAL CODE 932 (2d ed., 1971) (hereinafter cited as ANDERSON).

24. The section was so construed in *Prudential Ins. Co. v. Marine Nat'l Exchange Bank of Milwaukee*, 371 F. Supp. 1002 (D. Wis., 1974); and *Hicks-Costarino Co., Inc. v. Pinto*, 23 U.C.C. Rep. Serv. 680 (N.Y. Sup. Ct. 1978), and has thus been criticized by ANDERSON, *supra* note 23.

25. See, e.g., *Kraftsman Container Corp. v. United Counties Trust Co.*, 169 N.J. Super. 488, 404 A.2d 1288 (1979), and *Board of Higher Ed. v. Bankers Trust Co.*, 86 Misc. 2d 560, 383 N.Y.S.2d 508 (1976). "Good Faith" is defined in U.C.C. § 1-201(19) as "honesty in fact in the conduct or transaction concerned."

26. See, e.g., *Owensboro Nat'l Bank v. Crisp*, 27 U.C.C. Rep. Serv. 138 (Ky. App. 1979); *Travelers Indemnity Co. v. Center Bank*, 202 Neb. 274, 275 N.W.2d 73 (1979); *Underpinning & Foundation Constructors, Inc. v. Chase Manhattan Bank*, 46 N.Y.2d 459, 386 N.E.2d 7319 (1979). Cf., *Commercial Credit Corp. v. Citizens Nat'l Bank of Point Pleasant West Virginia*, 150 W.Va. 238, 144 S.E.2d 703 (1965); and *McConnico v. Third Nat'l Bank*, 499 S.W.2d 874 (Tenn. 1973) (circumstances denying the bank's status as holder in due course).

27. "Reasonable commercial standards applicable to the business of such representative" relates to "the banking business" when applied to banks. See *Atlas Bldg. Supply Co., Inc. v. First Indep. Bank of Vancouver*, 15 Wash. App. 367, 550 P.2d 76 (1976).

28. U.C.C. § 4-207.

29. See cases cited *supra* note 14.

arisen concerning: a.) whether a depository or collecting bank may raise this defense against a drawer or payee;³⁰ and b.) whether a drawee bank must assert this defense against its customer (the drawer) as a condition precedent to claiming against a depository or collecting bank for breach of warranties.³¹ The answer in both cases appears to be in the affirmative, based on the most recent authorities.³²

Apparently, section 3-406 may also be asserted as a defense where the drawer or drawee bank attempts to avoid the effect of the "final payment" rule³³ by showing that the depository bank was not an HIDC, or otherwise failed to act in good faith. In such a case, the Fifth Circuit held that a depository bank could assert the drawer's "alleged negligence as a defense," presumably with reference to section 3-406.³⁴

Two additional sections of Article 4 of the Code set forth defenses which banks may utilize as defenses to payment of losses arising from altered checks.

Code section 4-207(4) provides that unless a claim for breach of warranty under this section is made within a reasonable time af-

30. In other words, the Code's design is that a drawer or payee will only claim against the drawee bank which, in turn, will claim against the collecting and depository banks for breach of warranties. However, this design has been frustrated, as mentioned above, by courts having allowed direct actions by drawers and payees. For cases discussing the issue of whether, in such cases, the collecting or depository bank should be allowed to raise U.C.C. § 3-406 negligence as a defense, see *Cooper v. Union Bank*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1 (1973); *Prudential Ins. Co. of America v. Marine Nat'l Exchange Bank*, 55 F.R.D. 436 (E.D.Wis. 1972); *Trust Company of Georgia Bank of Savannah, N.A. v. Port Terminal and Warehousing Co.*, 153 Ga. App. 735, 266 S.E.2d 254 (1980).

31. U.C.C. § 4-406(5) requires a drawee or payor bank having a valid notice defense against its drawer to assert the defense or else the drawee bank's claim against the collecting or depository bank is waived. Since U.C.C. § 3-406 has no similar provision, the question has been litigated as to whether the drawee bank's failure to raise this defense would similarly bar its action against a collecting or depository bank. See, e.g., *Long Island Trust Co. v. National Bank of North America*, 28 U.C.C. Rep. Serv. 1442 (N.Y. Sup. Ct. 1980), and *Mellon Nat'l Bank v. Merchants Bank of New York*, 15 U.C.C. Rep. Serv. 691 (S.D.N.Y. 1972), holding that U.C.C. § 3-406 must have been asserted.

Contra, *Canadian Imperial Bank of Commerce v. Federal Reserve Bank of N.Y.*, 64 Misc. 2d 959, 316 N.Y.S.2d 507 (1970). Two other cases discussing this issue are *Clarkson v. Selected Risks Ins. Co.*, 170 N.J. Super. 373, 406 A.2d 494 (1979); *Girard Bank v. Mount Holly State Bank*, 474 F. Supp. 1225, 1236 (D.N.J. 1979).

32. See, e.g., *Sun'n Sand, Inc. v. United Cal. Bank*, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978); *East Gadsden Bank v. First Nat'l City Bank of Gadsden*, 50 Ala. App. 576, 281 So. 2d 431 (1973); see also discussions in ANDERSON, *supra* note 23 at 630-631, 938-945; Whaley, "Negligence and Negotiable Instruments", 53 N.C. L. REV. 1, 18-22 (1974) (hereinafter cited as Whaley); Feulner, *Check Forgeries: Variations of Rules of Liability Based on Fault — U.C.C. Defenses §§ 3-406, and 4-406*, 12 ARIZ. L. REV. 417, 432 (1970) (hereinafter cited as Feulner).

33. U.C.C. § 3-418.

34. *Perini Corp. v. The First Nat'l Bank of Habersham County*, 553 F.2d 398, 407 (5th Cir. 1977).

ter having learned of the breach, the bank will be discharged to the extent of any loss caused by the delay in making a claim.³⁵ Section 4-406 deals with negligence in failing to detect and report a forgery or alteration in sufficient time to protect the bank. The section operates only in favor of the drawee bank in defense of a claim by its drawer-customer.³⁶ If the drawee bank waives or fails to raise a valid section 4-406 defense against its customer, the drawee bank is precluded from recouping its loss against a collecting bank or other prior party to the instrument.³⁷

Without question, the most useful (and the most litigated) bank defenses to check forgery or alteration claims arise under U.C.C. sections 3-406 and 4-406. These sections address a claimant's negligence in contributing to the forgery or alteration, or his failure to give notice to the bank when the impropriety was discovered. The remainder of this article focuses upon these two Code sections.

II. NEGLIGENCE CONTRIBUTING TO FORGERY OR ALTERATION: U.C.C. SECTION 3-406

Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business.³⁸

A. Overview

Section 3-406 creates a defense, rather than a cause of action.³⁹

35. Again, the Code anticipates that such claims against depository or collecting banks will only be made by the drawee bank; *see supra* note 14. However, if direct actions may be brought by drawers or payees, it would seem that this section's "reasonable time" requirement would be available to the bank in such a direct action.

36. *Atlas Bldg. Supply Co. Inc. v. First Indep. Bank of Vancouver*, 15 Wash. App. 367, 550 P.2d 26 (1976).

37. U.C.C. § 4-406(5).

38. U.C.C. § 3-406. There are no variations among the states as to this provision; ANDERSON, § 3-406(2) at 940(1).

39. U.C.C. § 3-406 comment 5. However, in a recent decision, a United States District Court rejected a defense by the defendant depository bank that the plaintiff drawee bank failed to assert its drawer's negligence under U.C.C. § 3-406. While holding that the depository bank was liable to the drawee bank, notwithstanding the drawer's negligence, the court indicated that the depository bank might have a common law cause of action against the drawer for its negligence in

It does not, however, define the key terms "negligence" or "reasonable commercial standard of the drawee's or payor's business." Anderson states that the range of negligent behavior is "limited only by the limits of man's capacity for conducting slovenly business transactions."⁴⁰ A party's actions are to be judged by reference to the setting and peculiar circumstances. For example, private individuals may be judged by a more informal standard than commercial enterprises,⁴¹ and in all but the clearest cases, the decision is left solely to the judgment of the trier of fact.⁴²

B. A Bank Must Act According to "Reasonable Commercial Standards"

Before a bank can assert the claimant's negligence as a defense, the bank must affirmatively prove that it paid the instrument in good faith⁴³ and according to the reasonable standards of the banking profession.⁴⁴ If the defendant bank fails to make such a showing, it cannot take advantage of section 3-406 as a defense, regardless of the claimant's negligence.⁴⁵ The reasonable commercial standards test typically has been applied to the following classic cases:

1. Accepting or cashing items without all required signatures or endorsements

If a customer's signature card requires more than one authorized signature, the acceptance or cashing of an item without all of the required signatures is usually evidence of a failure to act ac-

causing the forgery and, presumably, the bank's loss. See, *Girard Bank v. Mount Holly State Bank*, 474 F. Supp. 1225 (D.N.J., 1979).

40. Anderson, *supra* note 23, at 626.

41. See, e.g., *Perley v. Glastonbury Bank and Trust Co.*, 170 Conn. 691, 368 A.2d 149 (1976).

42. U.C.C. § 3-406 comment 3; see also *Trust Company of Georgia Bank of Savannah, N.A. v. Port Terminal and Warehousing Co.*, 153 Ga. App. 735, 266 S.E.2d 254 (1980).

43. Defined in U.C.C. § 1-201(19); see also *Perley v. Glastonbury Bank and Trust Company*, 170 Conn. 691, 368 A.2d 149 (1976).

Similarly, under U.C.C. § 3-419(3), a depository or collecting bank has the burden of proving its "good faith" and that it acted "in accordance with reasonable commercial standards." See *R.A. Montgomery v. First Nat'l Bank*, 265 Or. 55, 508 P.2d 428 (1973).

44. See *Hermetic Refrigeration Company, Inc. v. Central Valley Nat'l. Bank, Inc.*, 493 F.2d 476, 477 (9th Cir. 1974).

45. U.C.C. § 3-406 comment 6; see also *Exchange Bank and Trust Co. v. Kidwell Constr. Co.*, 472 S.W.2d 117 (Tex. 1971); *First Nat'l Bank of Boston v. Hovey*, 412 N.E.2d 889, 894 (Mass. App. Ct. 1980); *Owensboro Nat'l Bank v. Crisp*, 608 S.W.2d 51, 53 (Ky. 1980).

cording to reasonable commercial standards.⁴⁶ However, where it is not clear that a check requires two signatures, the bank may be able to avoid liability. For example, in *Dominion Construction, Inc. v. First National Bank of Maryland*,⁴⁷ the drawer intended to issue a check payable jointly to "Town & Country Decorating, Inc. and Conwed Corporation." Instead, the check was made payable to "Town & Country Decorating and Conwed." The drawer's employee endorsed the item in his own name, "d/b/a/ Town & Country Decorating and Conwed." The bank allowed the item to be deposited in the employee's account, after having questioned the employee concerning the use of two names in his trade name and having received what was thought to be a reasonable explanation under the circumstances. The court held that this was "not a case in which the check reasonably appeared to be payable to joint payee;" moreover, there was "nothing on the face of the check to justifiably cause any suspicion on the part of [the bank], nor was there any other irregularity in the transaction."⁴⁸ The court also noted that this was a *deposit* to the employee's account, rather than the more risky act of paying cash across the teller's cage.

2. Failure to verify signatures

A number of banks have adopted the practice of not verifying signatures on checks below a certain amount — an amount they are understandably reluctant to disclose.⁴⁹ This is clearly an assumption of a calculated risk, since no reported case has absolved a bank from the duty to check signature cards. For example, in *Jackson v. First National Bank of Memphis*,⁵⁰ the drawee bank was found negligent under section 3-406 in failing to "closely examine" the drawer's signature and compare it with the signature card on file. The bank, of course, asserted that this procedure "was not practical under modern banking methods."⁵¹

46. See, e.g., *Key Appliance, Inc. v. National Bank of North America*, 75 A.D. 92, 428 N.Y.S.2d. 238 (1980).

47. 271 Md. 154, 315 A.2d 69 (1974).

48. *Dominion Constr. Inc. v. First Nat'l Bank of Maryland*, 271 Md. 154, 166-67, 315 A.2d 69, 74-76 (1974).

49. *U.C.C. Brief No. 13: Respective Liabilities of a Bank and Its Customers on Forged or Altered Checks*, 19 PRAC. LAW. 71, 79 (1973) (hereinafter cited as "U.C.C. Brief No. 13").

50. 55 Tenn. App. 545, 403 S.W.2d 109 (1966).

51. *Id.* at 113.

Generally, a bank will be held to have acted according to reasonable commercial standards if it shows that:

- a.) Its tellers were properly trained and generally instructed to check and verify signatures;⁵²
- b.) The signature card was attached to the cancelled check file;⁵³ and
- c.) There was an obvious similarity of signatures on the the items and cards which could be verified by lay witnesses.⁵⁴

3. Allowing the wrongdoer to cash or deposit a corporate item to his personal account

It is generally contrary to reasonable commercial standards for a depositary bank to allow a party to either cash or deposit to his own account an item which is made payable to some other payee (usually a corporation), unless the depositary bank has specific authority to do so. For example, in *Seattle-First National Bank v. Pacific National Bank of Washington*,⁵⁵ the depositary bank was held to have not acted in accordance with reasonable commercial standards when it allowed checks payable to a business corporation to be endorsed and deposited to the account of a business entity of a different name. The bank's action was a violation of its own manual of operation. Some courts have considered that the depositary bank has "notice of a claim"⁵⁶ by the true owner against the instrument when the bank allows checks made payable to one entity to be endorsed in the payee's name and paid to a different party.⁵⁷

A depositary bank may also be found negligent in cashing a drawer's check made payable to the bank and allowing it to be deposited to the individual's account.⁵⁸ In fact, a discrepancy in the

52. *Parsons Travel, Inc. v. Hoag*, 18 Wash. App. 588, 570 P.2d 445 (1977). However, there is also authority that once the clerk becomes "familiar" with the depositor's signature, the verification may be based upon the clerk's memory. See *Huber Glass Co., Inc. v. First Nat'l Bank of Kenosha*, 29 Wis. 2d 106, 138 N.W.2d 157 (1965).

53. *Parsons Travel, Inc. v. Hoag*, 18 Wash. App. 588, 570 P.2d 445 (1977).

54. *George Whalley Co. v. National City Bank of Cleveland*, 55 Ohio App. 2d 205, 380 N.E. 2d 742 (1977); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

55. 22 Wash. App. 46, 587 P.2d 617 (1978).

56. U.C.C. § 3-304(2). "The purchaser has notice of a claim against the instrument when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty." *Id.* This section precludes the bank from H.I.D.C. status.

57. See, e.g., *Mott Grain Co. v. First Nat'l Bank of Bismark*, 259 N.W.2d 667 (N.D. 1977). A collecting bank has been held to have acted contrary to "reasonable commercial standards" under U.C.C. § 3-419(3), by allowing a forger to deposit a check payable to a corporation in the personal account of the forger. See *Belmar Trucking Corp. v. American Bank & Trust Co.*, 65 Misc. 2d 31, 316 N.Y.S.2d 247 (1970).

58. *Federal Ins. Co. v. Groveland State Bank*, 372 N.Y.S.2d 18 (N.Y., 1975).

account number may be critical, as was the case in *First National Bank of San Antonio v. Nicholas and Barrera*.⁵⁹ Here the checks were made payable to "Depository Account No. 607,"⁶⁰ but were permitted to be deposited in an account of a different number, without endorsements. The Texas Court found that this action clearly evidenced a failure to exercise reasonable commercial standards.

In these situations the bank has a duty to inquire as to the specific authority of the presenting party to endorse and cash or deposit the instrument to his own account. A depository bank generally acts contrary to reasonable commercial standards when it violates either its own manual of operation or policies promulgated by such organizations as The American Institute of Banking or Banking Administration Institute. These organizations hold that it is a violation of sound banking practice to allow checks made payable to a corporation to be endorsed and paid into the account of an individual or other separate entity, unless done in accordance with specific authority or resolution.⁶¹ Most courts, however, will refuse to hold that the bank has violated reasonable commercial standards as a matter of law for such an infraction, leaving the issue to be decided in the context of specific facts.⁶²

4. Failure to inquire into suspicious circumstances

A drawee of depository bank must also act according to reasonable commercial standards when unusual or suspicious circumstances arise. In *Twellman v. Lindell Trust Company*,⁶³ the bank which issued a cashier's check was held not to have followed reasonable commercial standards in paying an item on which the en-

When a bank receives checks made payable to itself, and the bank is not a creditor of the drawer, it is charged with knowledge that the check has "commercial significance" and will be negligent in disbursing money to the drawer's agent without receiving "proper instructions" or making any inquiry as to the drawer's intended purpose for the check; *see Arrow Builders Supply Corp. v. Royal Nat'l Bank*, 21 N.Y.2d 428, 235 N.E.2d 756 (1968).

59. 500 S.W.2d 906 (Tex. Civ. App., 1973).

60. *Id.* at 908.

61. *Empire Moving and Warehouse Corp. v. Hyde Park Bank and Trust Co.*, 43 Ill. App. 3d 991, 357 N.E.2d 1196 (1976). The court held that the corporate depositor was entitled to summary judgment.

62. *See, e.g., Continental Bank v. Wa-Ho Truck Brokerage*, 122 Ariz. 414, 595 P.2d 206 (1979); *Trust Company of Georgia Bank of Savannah, N.A. v. Port Terminal and Warehousing Co.*, 153 Ga. App. 735, 266 S.E.2d 254, 258 (1980).

63. 534 S.W.2d 83 (Mo. App. 1976).

dorsement was "patently irregular."⁶⁴ The court noted that the endorsement did not have to be in exactly the same form as the named payee, so long as "there was nothing on the face of the instrument to arouse the suspicion of the bank. . .such as an obvious irregularity" with respect to the endorsement. Here the check was made payable to "International Harvester," but had been endorsed: "Pay to the order of [Individual's name] - Rodell Bros. International (sic)[,] Harvester Trucks (signed) Carle (sic) Roedel."⁶⁵ Similarly, in *Mortimer Agency, Inc. v. Underwriters Trust Co.*,⁶⁶ the court held that a drawee bank could be charged with negligence for paying out funds when "the physical appearance of the signature . . . considered together with the suspicious appearance [of accompanying documents] . . . and the exceptionally large amount of the check in relation to the usual pattern" indicated fraud or lack of authority.

Any fact may become relevant in determining whether the bank has acted according to reasonable commercial standards. For example, one court has held that where a bank permitted an employee of its largest customer to endorse an instrument in the name of known suppliers of the customer and to deposit the proceeds in a newly created account, the permission evidenced a failure to exercise reasonable procedures.⁶⁷ In *Mortimer*, the court emphasized that the branch was small, with only a few employees; moreover, the drawer's account was the largest in the bank and its operations were familiar to the bank employees. Negligence was also attributed to the drawee bank in *Jackson v. First National Bank of Memphis*,⁶⁸ for cashing a check in favor of one of the two authorized signatories for the drawer, a church. The drawee bank should have been put on inquiry as to whether or not the funds were being withdrawn for unauthorized purposes.

5. "Reasonable" vs. "common" banking standards

Code section 3-406 requires that the bank prove more than that its procedures were "common among banks."⁶⁹ The bank must

64. *Id.* at 91.

65. *Id.*

66. 73 Misc. 2d 970, 341 N.Y.S.2d 75, 78-9 (1973).

67. *Titan Air Conditioning Corp et al., v. Chase Manhattan Bank*, 61 A.D.2d 764, 462 N.Y.S.2d 12 (1978).

68. 55 Tenn. App. 545, 403 S.W.2d 109 (1966). Another case finding banks to have been negligent for failure to react to "suspicious circumstances" is *Employer's Liab. Assurance Corp. Ltd. of London, England v. Hudson River Trust Co.*, 250 A.D. 159, 294 N.Y.S. 698 (1937) (failure to inquire as to county check for substantial amount made payable to county treasurer).

69. U.C.C. § 3-406(b).

also show that such procedures were "reasonable."⁷⁰ In *Perley v. Glastonbury Bank and Trust Company*,⁷¹ the depository bank made no effort to verify the endorsement signatures, but instead introduced evidence that it was customary bank procedure to accept such a check as presented without authenticating the endorsements and to rely on its ability to charge the account of the payee if the endorsements proved invalid. The court responded:

Such procedure may well be common among banks, but the defendants [drawee and depository banks] failed to show that such conduct is reasonable. An examination of signature cards to determine the genuineness of endorsements may not be entirely practical under modern banking methods, but we do not feel that that necessarily relieves banks of the risk of loss on forged checks.⁷²

C. The Problem of Causation

Cases decided under common law and the NIL established that a party was precluded from claiming reimbursement for forged or altered instruments only when his negligent actions were the direct and proximate cause of the forgery.⁷³ Furthermore, such negligence was not to be considered the proximate cause of the loss unless it actually misled the payor.⁷⁴ Thus, absent the payor's reliance on the negligent acts, mere negligence or laxity in business affairs was held not to preclude either the drawer's action for improper payment or defense against a HIDC.⁷⁵ Given this pre-Code case law, the question has arisen whether U.C.C. section 3-406 evidences an intent to adopt a different test of causation.⁷⁶ Specifically, is negligence which substantially contributes to a forgery or material alteration of an instrument different from negligence which proximately causes the loss?

Although several courts have stated that they consider section 3-406 not to have changed the law concerning causation,⁷⁷ the ma-

70. See *First Nat'l Bank of Boston v. Hovey*, 412 N.E.2d 889, 894 (Mass. App. Ct. 1980); See also, Annot., 8 A.L.R. 2d 446 (1949).

71. 170 Conn. 691, 368 A.2d 149 (1976).

72. 170 Conn. at 703, 368 A.2d at 155.

73. See generally Annot., 39 A.L.R.2d 641, 647 (1955); Arant, *Forged Checks — The Duty of the Depositor to His Bank*, 31 Yale L.J. 598 (1922); BEUTEL, BRANNON'S NEGOTIABLE INSTRUMENTS LAW, § 23 at 455 (7th ed. 1948).

74. I.e., an "estoppel"; see *Union Trust Company v. Soble*, 192 Md. 427, 64 A.2d 744 (1949).

75. Annot., 39 A.L.R.2d 641, 645 (1955).

76. 6 BENDER'S U.C.C. SERVICE, W. WILLIER & F. HART, U.C.C. REPORTER-DIGEST, § 3-406 (1981) (hereinafter cited as WILLIER & HART).

77. *Society Nat'l Bank v. Capitol Nat'l Bank*, 30 Ohio App. 1, 281 N.E.2d 563

jority of decisions applying this section have barred a claim of forgery or material alteration if the claimant's negligence substantially contributed to the forgery or alteration.⁷⁸ Likewise, the weight of scholarly opinion supports the view that the phrase "substantially contributes to", as used in section 3-406, means nothing more than cause-in-fact, the sole issue being whether the negligence was a substantial factor (the Restatement test)⁷⁹ in the making of either an unauthorized signature or a material alteration.⁸⁰ This view has been said to include negligent conduct on the part of the drawer of a check which would have been too remote under the proximate cause standard of causation.⁸¹ Therefore, the question of causation under section 3-406 becomes a relatively simple factual inquiry. The more difficult policy determinations as to whether a duty existed can be formulated by the courts or legislatures, rather than being subsumed in the amorphous concept of proximate cause.⁸²

D. Nature and Degree of Negligence

1. Ordinary or extraordinary

At one time, the Pennsylvania Supreme Court believed that a finding of more than ordinary negligence was necessary under section 3-406 to preclude a claim for improper payment.⁸³ Apparently, the Court thought that the term "substantially" called for a higher degree of negligence rather than simply acting to modify the concept of causation.⁸⁴ However, this view has been universally rejected by other courts⁸⁵ and appears to have been aban-

(1972); *East Gadsden Bank v. City Nat'l. Bank*, 50 Ala. App. 576, 281 So.2d 431 (1973); *Jackson v. First Nat'l Bank*, 55 Ten. App. 545, 403 S.W.2d 109 (1926); *Jerman v. Bank of America Nat'l Trust & Sav. Assn.*, 7 Cal. App. 3d 882, 87 Cal. Rptr. 28 (1970); *Maddox v. First Westroads Bank*, 199 Neb. 81, 256 N.W.2d 647 (1977).

78. See *supra* note 76, at 2-958.4; Annot., 67 A.L.R.3d 144 § II[d].

79. The actor's negligent conduct is a legal cause of harm to another if [:]
(a) his conduct is a substantial factor in bringing about the harm, and (b) there is no rule of law relieving the actor from liability because of the manner in which his negligence has resulted in the harm. RESTATEMENT (SECOND) TORTS § 431 (1965).

80. *George Whalley Co. v. National City Bank of Cleveland*, 55 Ohio App. 2d 205, 380 N.E.2d 742 (1977); W. WILLIER & F. HART, *supra* note 76, at § 3-406; U.C.C. Brief No. 13, *supra* note 47, at 76.

81. *Dominion Constr., Inc. v. First Nat'l. Bank of Maryland*, 271 Md. 154, 315 A.2d 69, 74 (1974).

82. For a good criticism of "proximate cause", see Green, *Proximate Cause in Texas Negligence Law*, 28 TEX. L. REV. 471 (1950).

83. *National Bank and Trust Co. of Central Pennsylvania v. Commonwealth*, 9 Commonw. of Pa. 358, 305 A.2d 769 (1973).

84. Cf., *George Walley Co. v. National City Bank of Cleveland*, 55 Ohio App. 2d 205, 380 N.E.2d 742 (1977); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

85. Annot., 67 A.L.R.3d 144, 155-56 (1975).

done in Pennsylvania as well.⁸⁶ The prevailing view is that negligence in section 3-406 means: "Failure to exercise 'reasonable' or 'ordinary care', and that means the care which 'the ordinary prudent person' under the circumstances would exercise."⁸⁷

2. Hiring and supervising a clerk/bookkeeper

Most pre-Code and U.C.C. decisions have recognized an affirmative duty on the part of the banking institution to hire honest employees and to supervise their handling of commercial paper.⁸⁸ For example, it has been held to constitute evidence of negligence to employ a known gambler in a position in which false loan applications could be submitted by him to his employer, the drawer.⁸⁹ Additionally, the failure of a drawer to conduct an investigation of his accountant's credentials and background, followed by the hiring of the employee based solely upon the recommendation of a single individual, was held to be evidence of negligence under section 3-406.

A number of factors may determine the scope of the employer's duty to supervise their accounting employees and accounting employment practices. These relate to the nature of the employer's business, *i.e.*, its size, its compliance with accepted business practices for investigating employees, and the amount of the checks written or received by the particular business.⁹⁰ Other relevant factors might involve the particular employee, his background and references, his financial status, the quality of his performance, the scope of his responsibility, and prior work history. For example, one case held that twenty years of faithful service given

86. See *Commonwealth v. National Bank and Trust Co. of Central Pennsylvania*, 469 Pa. 188, 364 A.2d 1331, 1335 (1976), where the court noted that "[i]t is no longer open to question that the term 'negligence' as used in § 3-406, means the failure to exercise ordinary care" (citation omitted). *Id.*

87. *Perley v. Glastonbury*, 170 Conn. at 695, 368 A.2d at 153; see also *Fidelity and Casualty Co. of New York v. Constitution Nat'l Bank*, 167 Conn. 478, 356 A.2d 117 (1975); Annot., 67 A.L.R. 3d 144 (1975); W. WILLIER & F. HART, *supra* note 76, at § 3-406.

88. See Annot., 67 A.L.R.3d 144, 169 (1975).

89. *Prudential Ins. Co. of Am. v. Marine Nat'l Exch. Bank*, 55 F.R.D. 436 (E.D.Wis. 1972); *Cooper v. Union Bank*, 27 Cal. App. 3d 85, 507 P.2d 609, 107 Cal. Rptr. 1 (1972), *vacated* 9 Cal. 3d 371 (1973).

90. See *George Whalley Co. v. National City Bank of Cleveland*, 55 Ohio App. 2d 205, 380 N.E.2d 742 (1977); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

by an employee may justify the employer in lowering his guard.⁹¹ Even long-term employees, however, may not go completely unwatched.⁹²

Courts have also imposed a duty on the part of most businesses to conduct a periodic audit of sufficient thoroughness to catch the more obvious defalcations.⁹³ Also, employers have a duty to investigate the possibility of employee misuse of checks whenever suspicious circumstances occur, such as dramatically rising production costs,⁹⁴ sudden spending by a previously penurious employee,⁹⁵ or missing records.⁹⁶

3. Safeguarding checkbooks and check signing apparatus

A bank customer must take reasonable measures such as a "Protectograph," facsimile signature stamp, or signing machine, to prevent unauthorized use of his checkbook and signing equipment.⁹⁷ What constitutes reasonable measures depends, of course, upon the circumstances. In one case, the owner of a barber shop was held to be negligent for leaving blank checks in an unlocked drawer easily accessible to the faithless employee.⁹⁸ The normal procedure of the shop was that the checks were signed by hand, thus the employee was provided with the entire opportunity he needed to consummate the forgery. Yet, in *Fred Mayer, Inc. v. Temco Metal Products Co.*,⁹⁹ the court rejected the argument that the company was negligent in failing to keep its blank checks in safekeeping, or in failing to lock the "Protectograph" so as to render it unusable. The forgers, who were burglars, reached the checks and signing apparatus only after going through a skylight, kicking open the office door, and evading the owner's security service. In short, this case did not fall within the rule that one may be negligent for creating a situation that might

91. *Jackson v. First Nat'l Bank of Memphis*, 55 Tenn. App. 545, 403 S.W.2d 109 (1966).

92. See, e.g., *Ashley-Hall Ind., Ltd., Inc. v. Bank of New Orleans*, 389 So. 2d 850 (La. App. 1980); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

93. *Goodyear Tire and Rubber Co. v. First Nat'l Bank of Denver*, 95 Colo. 34, 32 P.2d 268 (Colo. 1934); *Detroit Piston Ring Co. v. Wayne County and Home Sav. Bank*, 233 N.W. 185 (Mich. 1930).

94. See *Detroit Piston Ring Co. v. Wayne County & Home Sav. Bank*, 233 N.W. 185 (Mich. 1930).

95. *Corbett v. Kleinsmith*, 112 F.2d 511 (6th Cir. 1940); *Scott v. First Nat'l Bank*, 343 Mo. 77, 119 S.W.2d 929 (1938).

96. *Westport Bank and Trust Co. v. Lodge*, 12 U.C.C. Rep. Serv. 450 (Conn. 1973); *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

97. U.C.C. § 3-406(7); see also Annot., 67 A.L.R.3d 144, 173 (1975).

98. *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

99. 267 Or. 230, 516 P.2d 80 (1973).

afford a third person an opportunity to commit a crime or tort.¹⁰⁰

4. Issuing the instrument, signing, and endorsing

Generally, a party is precluded from denying liability on an instrument where the forgery or alteration was facilitated by the form in which the instrument was drawn.¹⁰¹ Phrased in terms of a duty, a party must exercise reasonable care in the execution of an instrument so as to discourage a forgery or alteration.

Uniform Commercial Code section 3-406, comment b, states that "[n]egligence usually has been found where spaces are left in the body of the instrument in which words or figures may be inserted."¹⁰² A typical case is where an individual allows the payee to write the amount of the check, squeezed far to the right, and then signs the check, thus allowing the payee to easily raise the amount without a reasonable possibility of detection.¹⁰³ However, leaving a space to the right of the amount line does not necessarily constitute negligence as a matter of law. A Texas court found an absence of negligence when a woman signed a check prepared by her son-in-law in this fashion.¹⁰⁴ Conversely, a Florida court held negligent an employer who signed a paycheck drawn with spaces and left it for signature by the employee-payee.¹⁰⁵ In other words, the degree of commercial sophistication of the drawer and his relationship to the payee are relevant factors in determining what constitutes negligence.

Improperly filling in the name of the payee is another common check writing hazard. It is questionable whether the drawer has a duty to fill in blank spaces after written designation of the named payee so as to prevent the addition on the instrument of an alternate payee who could singularly endorse and cash the instrument.¹⁰⁶ However, if the drawer intends to name joint payees, both of whom are to endorse, the instrument must clearly show that they are separate entities on the face of the check. Other-

100. See generally, RESTATEMENT (SECOND) TORTS § 4 (1965).

101. Annot., 22 A.L.R. 1139(I), (III) (1923); 67 A.L.R.3d 144, at 151-52 (1975).

102. U.C.C. § 3-406 comment 3.

103. See, e.g., *Williams v. Montana Nat'l Bank of Bozeman*, 167 Mont. 24, 534 P.2d 1247 (1975). *Leonard Nat'l Bank of West Virginia at Wheeling*, 150 W. Va. 267, 145 S.E.2d 23 (1965).

104. *Glasscock v. First Nat'l Bank*, 114 Tex. 207, 266 S.W. 393 (1924); see also *Ray v. Farmers State Bank of Hart*, 576 S.W.2d 607 (Tex. 1979).

105. *Goldsmith v. Atlanta Nat'l Bank*, 55 So.2d 804 (Fla. 1951).

106. See, e.g., *Gutfreund v. E. River Nat'l Bank*, 167 N.E. 171 (1929).

wise the drawer may be held negligent when one payee endorses both names, representing to the bank that the two payees were in fact a single entity under which name the wrongdoer was doing business.¹⁰⁷ Furthermore, if checks are intended for the benefit of a particular party, but are made payable to a named bank, such practice may facilitate the endorsement and deposit to the account of a wrongdoer unless the check and accompanying documents indicate the specific purpose and intended beneficiary of the check.¹⁰⁸

5. Delivery of the instrument

Comment 7 to section 3-406 states that the section is intended to preclude recovery "where a check is negligently mailed to the wrong person having the same name as the payee." Although this type of negligent delivery can occur, and has in fact occurred,¹⁰⁹ more difficult questions are presented when the drawer entrusts the instrument to a non-payee for the purpose of delivery to the intended payee.¹¹⁰

A principle which can be distilled from the delivery cases is that the drawer may entrust the instrument to a non-payee for delivery to the intended payee, provided there are no reasonable grounds for suspicion of potential misappropriation, forgery, or alteration of the instrument.¹¹¹ In other words, the drawer is not required to anticipate a forgery or alteration of the instrument, but cannot put his "head in the sand" if there is cause to suspect that this might occur.¹¹²

A corollary to this principle is that where business or trade rules apply regarding delivery of negotiable instruments, the drawer will in most cases be found negligent if a failure to follow these rules "substantially contributes to" the forgery or alteration. For example, in *Fidelity and Deposit Co. of Maryland v. Chemical Bank New York Trust Co.*,¹¹³ the stockbroker-drawer

107. *Dominion Constr., Inc. v. First Nat'l Bank of Maryland*, 271 Md. 154, 315 A.2d 69 (1975).

108. *First Fed. Sav. and Loan Ass'n of Sioux Falls v. Union Bank and Trust*, 291 N.W.2d 282 (S.D. 1980).

109. *Park State Bank v. Arena Auto Auction, Inc.*, 59 Ill. App. 2d 235, 207 N.E.2d 158 (1965).

110. *See generally* Annot., 67 A.L.R.3d 144 §9 (1975).

111. Two cases following this principle are *Guaranty Bank and Trust Co. v. Federal Reserve Bank of Kansas City*, 454 F. Supp. 488, 491 (W.D. Okla. 1977); *Guardian Life Ins. Co. of Am. v. Chemical Bank*, 47 A.D.2d 608, 363 N.Y.S.2d 820 (App. Div. 1975).

112. *See, e.g., Twellman v. Lindell Trust Co.*, 534 S.W.2d 83, 90 (Mo. Ct. App. 1976).

113. 65 Misc. 2d 619, 318 N.Y.S.2d 957 (App. Div. 1970), *affirmed*, 333 N.Y.S.2d 726 (1972).

was found negligent for delivering checks to an attorney who misrepresented his status as agent of the stock owners. The stockbroker-drawer's failure to verify the attorney's authority was a violation of the New York Stock Exchange "Know Your Customer" rule. However, in a widely discussed case,¹¹⁴ the Eighth Circuit Court of Appeals in *Bagby v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,¹¹⁵ on facts remarkably similar to those in *Fidelity and Deposit*, reached a different result. Interestingly, although the *Bagby* court agreed that the section 3-406 test for causation was the equivalent of the Restatement "substantial factor" test, it nevertheless found that the drawer's admitted failure to follow the "Know Your Customer" rule contributed only to the *issuance* of the check, rather than to the forgery. The court thus followed what was essentially a "proximate cause" rationale. Apparently, the *Bagby* court made a policy determination that negligent delivery of an instrument — even in violation of the drawer's rules — should not preclude a drawer from asserting forgery as a defense. The case has been generally criticized as a result.

6. Review of bank statements and cancelled checks

The depositor's duty to review his bank statements and cancelled checks to detect forgeries and alterations is specifically required by section 4-406 and is discussed below.¹¹⁶ Suffice it here to say that cases decided under section 3-406 have also recognized a depositor's duty to exercise reasonable care and promptness in reviewing bank statements and cancelled checks.¹¹⁷ Accordingly, a depositor's failure in this respect will preclude him from claiming improper payment due to forgery or alteration.¹¹⁸

114. See generally, W. WILLIER, & F. HART, *supra* note 76.

115. 491 F.2d 192 (8th Cir. 1974).

116. See generally, W. WILLIER & F. HART, *supra* note 76, at § 3-406; see also *Whaley*, *supra* note 32 at 22.

117. See, e.g., *Myrick v. National Sav. and Trust Co.*, 268 A.2d 526 (Dist. Ct. App. 1970); *Ashley-Hall Interiors, Ltd., Inc. v. Bank of New Orleans*, 389 So. 2d 850 (La. App. 1980).

118. Certain distinctions and overlaps between the coverage of U.C.C. § 3-406, and U.C.C. § 4-406 are discussed in §IV, *infra*.

III. NEGLIGENCE IN DETECTING FORGERIES AND MATERIAL ALTERATIONS: U.C.C. SECTION 4-406.

A. Overview

U.C.C. section 4-406(1) provides that after the bank makes the cancelled checks and statement available, the customer "must exercise reasonable care and promptness to examine the statement and items to discover his unauthorized signature or any alteration on an item and must notify the bank promptly after discovery thereof." If the customer fails in these duties with respect to any single item, he is precluded from claiming forgery or alteration: a.) With respect to that item, if the bank suffers a loss as a result;¹¹⁹ and b.) with respect to any subsequent item (until the bank is notified) which is forged or altered by the same wrongdoer after a reasonable period of time (not to exceed fourteen days) from the time that the first such item and statement was made available to the customer.¹²⁰

However, even if the customer is negligent and fails to give the required notice, the customer may still claim improper payment of forged or altered items if he "establishes [a] lack of ordinary care on the part of the bank in paying the item[s]."¹²¹

B. The Customer's Duties and Responsibilities

1. Generally

The customer's duty to "exercise reasonable care and promptness" in examining his statement and cancelled checks is not defined in the Code. In fact, there are relatively few cases which have dealt with this duty. Pre-Code cases held, as a minimum, that the customer's reconciliation procedure should include the following steps:

- a.) A comparison of the cancelled checks with the check stubs;
- b.) A comparison of the statement balance with the checkbook balance; and
- c.) A comparison of the returned checks with the debits indicated on the statement.¹²²

What constitutes "reasonable care" under section 4-406 is, of

119. U.C.C. § 4-406(2)(a).

120. U.C.C. § 4-406(2)(b).

121. U.C.C. § 4-406(3).

122. See generally *Stumpp v. Bank of New York*, 212 A.D. 608, 209 N.Y.S. 396, 402 (1925); *Huber Glass Co. v. First Nat'l Bank of Kenosha*, 29 Wis. 2d 106, 111, 138 N.W.2d 157, 161 (1965); *Clarck v. Camden Trust Co.*, 84 N.J. Super. 304, 201 A.2d 762, 766 (1964); 10 AM. JUR. 2d *Banks* §§ 512, 569, 604; Comment, *Allocation of Losses from Check Forgeries Under the Law of Negotiable Instruments and the U.C.C.*, YALE L. J. 417, 449 (1953); Penny, *Bank Statements, Cancelled Checks and Article 4 in the Electronic Age*, 65 MICH. L. REV. 1341, 1349 (1967).

course, a question of fact, although there are relatively few rules. The depositor is not immediately required to examine checks for forgeries of endorsements.¹²³ However, as a practical matter the customer should do so, since after three years, without regard to reasonable care, he will be absolutely barred from claiming improper payment on a forged endorsement.¹²⁴ Moreover, one writer has suggested that although a duty to examine for forged endorsements may not exist under section 4-406(1), it may, perhaps, arise under section 3-406.¹²⁵

As is the case with "reasonable care," there is no Code definition of what constitutes "promptness" or "reasonable time." One case has held that these standards generally create questions of fact which "can only be answered by taking into consideration the circumstances of the particular case."¹²⁶

2. Customer's responsibility for dishonest employees

The classic scenario of forged or altered check cases is the faithless bookkeeper who attempts to cover his trail by either withholding the depositor's monthly statement and cancelled checks or submitting the statement and checks to the depositor after having removed the forged or altered items. The question often presented is, what effect, if any, such cover-up efforts have on the depositor's duties under section 4-406. Although the Code gives no clear answer to the question,¹²⁷ the cases decided since the Code was adopted clearly state the applicable principles.

First, the fact that the depositor's employee attempts to conceal

123. *Winkie, Inc. v. Heritage Bank of Whitefish Bay*, 99 Wis. 2d 616, 299 N.W.2d 829 (1981); *Clarkson v. Selected Risks Ins. Co.*, 170 N.J. Super. Ct. 373, 406 A.2d 494, 500 (1979). However, Comment 6 to U.C.C. § 4-406 provides that "nothing in this section is intended to affect any decision holding that a customer who has notice of something wrong with an endorsement must exercise reasonable care to investigate and notify the bank". *Id.*

124. U.C.C. § 4-406(4); see *infra* § V and accompanying discussion.

125. See *Whaley*, *supra* note 32, at 37. This would be particularly so where there were continuing forged signatures, and the customer's negligence "substantially contributing" to the subsequent forgeries. *Id.*

126. *Clarkson v. Selected Risks Ins. Co.*, 170 N.J. Super Ct. 373, 406 A.2d 494 (1979).

127. Pre-Code cases gave varying responses to these question ranging from the notion that if the depositor used ordinary care in the selection of his employees, he had fulfilled his duty to the bank, *Kenneth Inv. Co. v. National Bank*, 103 Mo. 613, 77 S.W. 1002 (1903), to the view that the guilty knowledge of the employee was imputed to the employer, see *generally* Annot., 15 A.L.R. 159; 36 A.L.R. 327 (1925); 67 A.L.R. 72 (1930); 103 A.L.R. 1147 (1936).

the forgery "does not obviate the customer's responsibility to examine his own bank statement."¹²⁸ Secondly, the majority and better reasoned view as to this imputation of knowledge is that the depositor-employer is charged only with notice of what would have been disclosed had an "honest employee" reconciled the bank statement and book. "[T]he employer, though not imputed with knowledge of the fraud of his faithless agent, is, as principal, chargeable with such information as an honest employee, unaware of the wrongdoing, would have acquired from the examination of the cancelled checks and bank statements."¹²⁹

The question yet to be answered is what effect an exceptionally skilled cover-up by the bookkeeper will have on the depositor's duties under section 4-406. The principle quoted above implies that if the cover-up is so skillful that it would fool the hypothetical "honest employee," then the employer-depositor would, to that extent, be excused from his duty of reporting the fraud to the bank.

3. Customer's duty to conduct periodic audits: duty to inquire

Although the facts of each case would control, at least one court has found evidence of negligence on the part of a depositor-drawer for failing to perform regular audits of its business.¹³⁰ Also, if the depositor has not received statements of cancelled checks from the bank, the burden seems to be on him to inquire as to the reasons why.¹³¹

4. Bank's burden of proof

Section 4-406(2) places a dual burden of proof on the bank to: 1.) establish that the customer failed to "exercise reasonable care and promptness" in examining the statement and enclosed items; and 2.) prove that the bank "suffered a loss" by reason of such failure.¹³² It has been held that the bank "suffers a loss" within the meaning of this section whenever it pays an item which cannot be charged to the customer because the bank was not notified

128. *Kiernan v. Union Bank*, 55 Cal. App. 3d 111, 127 Cal. Rptr. 441 (1976); *Pine Bluff Nat'l Bank v. Kesterson*, 257 Ark. 813, 822, 520 S.W.2d 253, 258 (1975).

129. *Kiernan v. Union Bank*, 55 Cal. App. 3d 111, 127 Cal. Rptr. 441 (1976); *see also* *George Whalley Co. v. National City Bank of Cleveland*, 55 Ohio App. 2d 205, 380 N.E.2d 742 (1977); *In re Parry Lines, Inc.*, 150 F. Supp. 693, 700 (S.D.N.Y. 1957); *Clark v. Camden Trust Co.*, 84 N.J. Super. 304, 201 A.2d 762 (1964). *See also* 10 AM. JUR. 2d *Banks*, § 514, at 483-84 (1963).

130. *Indiana Nat'l Corp. v. FACO, Inc.*, 400 N.E.2d 202 (Ind. App. 1980).

131. *See* *Terry v. Puget Sound Nat'l Bank*, 80 Wash. 2d 157, 492 P.2d 534 (1972).

132. U.C.C. § 4-406(2)(a).

in time to avoid the loss.¹³³

Apparently, the bank does not have to show a "loss" with respect to subsequent items forged by the same wrongdoer after the first such item is made available to the customer. The official comments to section 4-406 state that payment of additional forged or altered items to the same wrongdoer is a "loss suffered by the bank" due to the customer's negligence in allowing the wrongdoer to repeat his misdeeds.¹³⁴

C. Bank's Duty to Act with "Ordinary Care"

1. Generally

U.C.C. section 4-406(3) provides that "[t]he preclusion under subsection (2) does not apply if the customer established lack of ordinary care on the part of the bank in paying the item(s)." This section essentially states that if the bank fails to use ordinary care it always bears the loss, whether or not the customer was negligent, presumably without regard to the degree of the customer's negligence.¹³⁵ Not surprisingly, the question of whether the bank exercised ordinary care with regard to "a particular situation or combination of circumstances" is decided by the trier of fact.¹³⁶

The Code does not define the term "ordinary care" under section 4-406(3); however, it does state that certain practices are deemed either absolutely or *prima facie* to constitute ordinary care:

Action or non-action approved by [Article 4] or pursuant to Federal Reserve regulations or operating letters constitutes the exercise of ordinary care and, in the absence of special instructions, action or non-action con-

133. *Winkie, Inc. v. Heritage Bank of Whitefish Bay*, 99 Wis. 2d 616, 299 N.W.2d 829 (1981).

134. U.C.C. § 4-406, comment 3.

135. *Hanover Ins. Cos. v. Brotherhood State Bank*, 482 F Supp. 501, 504 (D. Kan. 1979); *see also* *Exchange Bank and Trust Co. v. Kidwell Constr. Co.*, 463 S.W.2d 465 (Tex. Civ. App. 1971). This responsibility is possibly justified by the conception that "a bank . . . is equipped to discover forgeries and to safely preserve its depositor's money. The bank holds out to the public that its offices and agents are skilled in all matters connected with and relating to its ability to detect and prevent forgeries". *Union Wholesale Co. v. Bank of Delaware*, 55 Del. 223, 243, 190 A.2d 761, 771 (1963), *quoting* *Deer Island Fish & Oyster Co., v. First Nat'l Bank*, 166 Miss. 162, 146 So. 116, 120 (1933).

136. *Hanover Ins. Co's v. Brotherhood State Bank*, 482 F. Supp. 501 at 506 (D. Kan. 1979); *Exch. Bank and Trust Co. v. Kidwell Constr. Co.*, 463 S.W.2d 465 (Tex. Civ. App. 1971). *See also* *Jackson v. First Nat'l Bank of Memphis*, 55 Tenn. App. 545, 403 S.W.2d 109 (1966).

sistent with clearing house rules and the like or with a general banking usage not disapproved of by this Article, *prima facie* constitutes the exercise of ordinary care.¹³⁷

The most frequently litigated issues concern whether certain "general banking usages" or practices, *i.e.*, not verifying the validity of signatures, constitute "ordinary care." The short answer to this problem is, "not necessarily." In *Hanover Insurance Company v. Brotherhood State Bank*,¹³⁸ the bank introduced evidence to establish that the payees' identities were not normally investigated if the checks were for small amounts, in accordance with "the standards of local banking usage." The district court recognized that "local banking practices may be useful in determining the standard of ordinary care required by [U.C.C. §4-406(3)]", but, nevertheless, do not automatically exonerate the bank. The court stated that "No matter what minimal standards are suggested by local banking usage, [such usage] cannot amend the statutory requirement of ordinary care. . . . 'Even an entire industry, by adopting such careless methods to save time, effort or money, cannot be permitted to set its own uncontrolled standard.'"¹³⁹ Similarly, an Alabama court held that evidence of action pursuant to "common banking standards" must also be shown not to be "unreasonable, arbitrary, or unfair."¹⁴⁰ Therefore, even though a bank may introduce evidence that it is "not practical under modern banking methods" to examine each signature, it "cannot escape the consequences" when a signature turns out to be forged.¹⁴¹ This does not mean that the bank has a duty to hire additional employees to examine checks, but it does mean that the bank must assume the risk of such business decisions.¹⁴²

2. Proof of the lack of ordinary care

Typically, proof of the bank's lack of ordinary care will be of two types; either that the bank's procedures were below the standard, or that the bank's employees failed to exercise ordinary care in processing the particular items.

To illustrate the first type of negligence, the bank's "system" may be measured against either general modern banking procedures or the generally accepted banking practice in the area, as

137. U.C.C. § 4-103(3).

138. 482 F. Supp. 501 (D.Kans. 1979).

139. 482 F. Supp. at 506; *see also* PROSSER, LAW OF TORTS 167 (4th ed. 1971).

140. *Industrial Sys. of Huntsville, Inc. v. Am. Nat'l Bank of Huntsville*, 376 So. 2d 742, 745 (Ala. Civ. App. 1979).

141. *Jackson v. First Nat'l Bank of Memphis*, 55 Tenn. App. 545, 403 S.W.2d 109 (1966).

142. *Hanover Ins. Co. v. Brotherhood State Bank*, 482 F. Supp. 501, 510 (D.Kan. 1979).

evidenced by expert testimony.¹⁴³ Where the only evidence presented is a description of procedures followed by the particular bank, the bank's system must be measured by a judicial conception of reasonableness.¹⁴⁴ Under either approach, examples of relevant evidence include the instructions and training given to employees for detecting forgeries or alterations,¹⁴⁵ the number of persons performing a visual examination of the checks in question,¹⁴⁶ whether each check is compared to a signature card or simply to the clerk's "mental image" of the signature,¹⁴⁷ and how many checks a single clerk handles each day.¹⁴⁸

The more likely attack against the bank will be to show the bank employee's negligence in paying a forged or altered check which a competent teller or clerk should have noticed.¹⁴⁹ Proof on this question normally requires putting the checks into evidence, together with the signature card, and an effort to get the employee who examined the checks to admit that some of them ought not to have been paid. However, a bank clerk "cannot be held to a degree of expertness of a handwriting expert . . . for the standard is that of ordinary care."¹⁵⁰ So, the bank may counter this attack by calling a handwriting expert to testify that the

143. *Nu-Way Services, Inc. v. Mercantile Trust Co.* Nat'l Ass'n, 530 S.W.2d 743, 746-747 (Mo. App. 1975); see also *Basch v. Bank of Am.*, 22 Cal. 2d 16, 139 P.2d 1 (1943); 13 AM. JUR. 2d, *Proof of Facts* §§ 4-6, at 354-360 (1977).

144. *Industrial Sys. of Huntsville, Inc. v. American Nat'l Bank of Huntsville*, 376 So. 2d 742, 745 Ala. Civ. App. 1979). See *supra* note 135, at 745.

145. For example, in *Clyman v. Marks*, 39 Misc. 2d 198, 204, 240 N.Y.S.2d 532, 538 (1963), a pre-Code case, the court noted that "some modicum" of training must be given to tellers, so they can at least recognize an "obvious" discrepancy in signatures; see also *First Nat'l Bank and Trust Co. v. Cutright*, 189 Neb. 805, 205 N.W.2d 542 (1973).

146. *Screenland Magazine v. National City Bank*, 181 Misc. 454, 42 N.Y.S.2d 286, 290 (1943).

147. At least two cases have held that it is acceptable for clerks to examine signature cards until they are familiar with the authentic signatures, then to examine the signatures on the checks without actual reference to the signature cards. *Nu-Way Serv., Inc. v. Mercantile Trust Co.*, Nat'l Ass'n, 50 S.W.2d 743 (Mo. App. 1975); *Huber Glass Co., Inc. v. First Nat'l Bank of Kenosha*, 29 Wis. 2d 106, 111, 138 N.W.2d 157, 161 (1965).

148. *Nu-Way Services, Inc. v. Mercantile Trust Co.* Nat'l Ass'n, 530 S.W.2d 743, 746-747; see also *Exchange Bank and Trust v. Tidwell Constr. Co.*, 84 N.J. Super. 304, 201 A.2d 762 (1964).

149. See, e.g., *First Nat'l Bank of Melbourne v. Sogaard and Debo, Inc.*, 406 F.2d 1128 (5th Cir. 1969).

150. "Reasonable care" on the part of the bank does not call for "expertness" on the part of its tellers, but it does call for prudence. *Clyman v. Marks*, 39 Misc. 2d 198; see also, *Industrial Sys. of Huntsville, Inc. v. American Nat'l Bank of Huntsville*, 376 So. 2d 742 (Ala. Civ. App. 1979).

checks are such excellent forgeries that even an expert teller or bookkeeper could not have detected them.¹⁵¹ It has been held that such testimony cannot be deemed expert, unless the witness himself is a banker, or one qualified to testify as to what a knowledgeable, experienced and careful teller would be able to discover under normal banking conditions.¹⁵²

3. Application to particular practices

One might suppose that the term "reasonable commercial standards" as used in section 3-406 requires something more or less than "ordinary care" under section 4-406(3);¹⁵³ however, most courts have made no distinction between these standards in applying them to banks.¹⁵⁴ Consequently, the cases dealing with whether a bank has acted according to "reasonable commercial standards" under section 3-406 would be relevant authority here.¹⁵⁵

Two recent cases, however, have dealt with the bank's duty to exercise "ordinary care" under section 4-406(3) without mention of section 3-406.¹⁵⁶ In both cases, the court held that a drawee bank had a duty not only to check the validity of the drawer's signature, but also a duty to inquire into the validity of the payee's endorsement as well. For example, in *Hanover*, the payee's name had been stricken in a "conspicuous and maladroit" fashion, and the name of the faithless employee was substituted who endorsed the check. The court noted that "the substantial amounts of the checks involved . . . and the ease with which a telephone call could have confirmed the payee" are factors which showed a lack of ordinary care on the part of the banks.¹⁵⁷

4. Burden of proof as to the bank's duty

U.C.C. section 4-406(3) completely reversed the common law

151. *Ashley-Hall Interiors, Ltd., Inc. v. Bank of New Orleans*, 389 So. 2d 850 (La. App. 1980).

152. *See, e.g., Thoreson v. Citizens State Bank*, 294 N.W.2d 397, 401 (N.D. 1980); *Basch v. Bank of Am. Nat'l Trust and Sav. Ass'n*, 22 Cal. 2d 316, 139 P.2d 1 (1943); *Kimball v. Rhode Island Hosp. Nat'l Bank*, 72 R.I. 144, 48 A.2d 420 (1946).

153. *See infra* § IV and accompanying discussion.

154. *See, e.g., Exchange Bank and Trust Co. v. Kidwell Constr. Co.*, 463 S.W. 2d 465 (Tex. Civ. App. 1971); *Jackson v. First Nat'l Bank of Memphis*, 55 Tenn. App. 545, 403 S.W.2d 109 (1966); *Ashley-Hall Interiors, Ltd., Inc. v. Bank of New Orleans*, 389 So. 2d 850 (La. App. 1980).

155. *See supra* § IIB and accompanying discussion.

156. *Hanover Ins. Co's. v. Brotherhood State Bank*, 482 F. Supp. 501, 504 (D.Kan. 1979); *See also Thoreson v. Citizens State Bank*, 294 N.W.2d 397, 401 (N.D. 1980).

157. 482 F. Supp. 501, 505. *But see Cooper v. Union Bank*, 9 Cal. 3d 371, 507 P.2d 609, 107 Cal. Rptr. 1 (1973).

rule;¹⁵⁸ thus, the burden of proof with respect to the bank's negligence is now placed on the customer, rather than requiring the bank to demonstrate its freedom from negligence.¹⁵⁹ The Code comments state that this "redistribution" of the burden of proof was to provide "reasonable equality of treatment" as between the bank and the customer, rather than requiring one party, *i.e.*, the bank, "to establish that his entire course of conduct constituted ordinary care."¹⁶⁰ If this is so, one can only wonder why the bank is saddled with proving that its "entire course of conduct" was in accordance with "reasonable commercial standards" under U.C.C. section 3-406.

IV. RELATIONSHIP BETWEEN U.C.C. SECTION 3-406 AND U.C.C. SECTION 4-406.

A. Similarities and Differences

Code sections 3-406 and 4-406 are related, yet also dissimilar, in several respects which can lead to some confusion. Both sections preclude the customer from claiming against the bank if the customer's negligence in detecting the forgery or alteration resulted in delayed notice to the bank.¹⁶¹ Also, both sections provide that negligence on the part of the bank excuses the negligence of the customer. However, the two sections are substantially different in the following respects:

1.) U.C.C. section 4-406 deals strictly with the relationship between a customer and his bank,¹⁶² whereas section 3-406 can preclude other parties, such as a negligent payee, from claiming against a bank.

2.) U.C.C. section 3-406 deals primarily with a customer's negligence *prior* to the forgery or alteration, whereas section 4-406 deals with the customer's negligence *after* the forged or altered check is paid by the bank. However, as noted above, the cus-

158. The burden of proof is on the bank to an absence of negligence; *see* Kimball, Inc. v. Rhode Island Hosp. Nat'l Bank, 72 R.I. 144, 48 A.2d 420 (1946).

159. *See, e.g.*, Huber Glass Co. v. First Nat'l Bank, 29 Wis. 2d 106, 111, 138 N.W.2d 157, 161 (1965).

160. U.C.C. § 4-406, comment 4.

161. *See supra* § IID(6) and accompanying discussion.

162. However, in *Sun'n Sand, Inc. v. United Cal. Bank*, 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978), it was held that a depository bank, when sued in a direct action by the drawer, may raise the defense that the drawer failed to give notice to its drawee bank as required by U.C.C. § 4-406(1).

tomer's negligence in failing to detect the first forgery *after the fact* by, failing to examine bank statements and checks, may contribute to the making of subsequent forgeries by the same wrongdoer under section 3-406.

3.) Although the customer may have no *duty* to check for forged or altered endorsement under U.C.C. section 4-406, there is, arguably, a duty to do so under section 3-406.¹⁶³

4.) The standard of care required of the bank is phrased in terms of "reasonable commercial standards" under U.C.C. section 3-406 and "ordinary care" under section 4-406(3).

B. "Reasonable Commercial Standards" or "Ordinary Care"

It has been argued that the phrase "reasonable commercial standards" under section 3-406 was intended to require a dissimilar degree of care than the "ordinary care" required by banks under section 4-406(3).¹⁶⁴ It is more likely, however, that the drafters intended "reasonable commercial standards" to be substantially the same as the "ordinary care" standard. Official Comment 6 to section 3-406 implies this when it states: "[Section 3-406] protects parties who act. . . in observance of the reasonable standards of *their business*. Thus, any bank which takes or pays an altered check which *ordinary banking standards* would require it to refuse cannot take advantage of the estoppel."¹⁶⁵ The use of different terms, as applied to banks, could be attributed to the fact that Article 3 deals with more than banking practices, and the drafters did not intend to impose general commercial standards of banks already bound by the specific requirements of Article 4. Moreover, banks may have greater flexibility under the standards relating to "their business". Consider U.C.C. section 4-103(4) which states: "The specification or approval of certain procedures by this Article does not constitute disapproval of other procedures which may be reasonable under the circumstances." There is no Article 4 provision comparable to section 3-406, which appears to require non-bank commercial enterprises to prove the notoriety of the particular practice in question. Finally, as noted earlier, the cases applying section 3-406 and section 4-406 standards of care to banking practices do not seem to draw a material distinction between the two.

163. *Whaley, supra* note 32, at 37, n.136.

164. Comment, *Forgeries and Material Alterations: Allocation of Risks Under the U.C.C.*, 50 B.U.L. REV. 536 (1970).

165. U.C.C. § 3-406 comment 6 (emphasis added).

C. Burdens of Proof

Both sections 3-406 and 4-406 require the bank to prove the customer's negligence. Under section 3-406 the bank must, in addition, prove that it acted according to "reasonable commercial standards," whereas under section 4-406(3) this is not so. Rather, the customer, in order to avoid a claim of section 4-406(1) negligence, must shoulder the burden of proving that the bank did not act with "ordinary care."

An interesting dilemma thus arises when both section 3-406 and section 4-406 are at issue in the same case. For example, a bank may seek to show that its customer was negligent in contributing to a forgery under section 3-406 and in failing to detect the forgery under section 4-406(1). This showing would not be difficult since the bank has the burden of proof under both Code sections. However, the customer, in an effort to avoid the effect of its alleged negligence, may charge that the bank was negligent in paying out funds without verifying signatures. Under section 3-406, the bank must prove that it paid the funds according to the "reasonable commercial standards" of the banking business. Under section 4-406, however, the customer has the burden of proving the opposite. What should the result be when such a conflict between U.C.C. provisions occurs?

First, since the bank's own negligence will excuse the customer's negligence under both Code sections, that issue should be determined before addressing the issue of the customer's negligence. Second, it would seem that a determination of the bank's negligence under section 3-406 should next be determined because that Code section deals with events occurring prior in time to the subject matter of section 4-406. Moreover, if the customer's negligence in failing to detect subsequent forgeries or alterations by the same wrongdoer is an issue, that determination may also fall under section 3-406. Thus, if the bank's negligence under section 3-406 is to be determined first, the bank will have the burden of proving the propriety of its action in not detecting the forgery or alteration. If the bank should fail in this undertaking and no other bank defenses are available, then the customer would win. If, however, the bank succeeds in proving that it used due care under section 3-406, then it would proceed to try to prove the customer's negligence under both section 3-406 as well as section 4-406. The customer then would be compelled to both rebut the

bank's proof of the customer's negligence, and try to show the bank's failure to act with "ordinary care" under section 4-406(3).

V. NOTICE REQUIREMENTS AND PERIODS OF LIMITATION: U.C.C.
SECTION 4-406

A. *Generally*

It is common practice for banks to send itemized monthly statements to their customers, and to include checks that have been paid from that customer's accounts. When this is done, section 4-406 imposes certain duties and consequences with respect to a customer's duty to give notice to the bank of forged or altered checks. Essentially, these are as follows:

1. The customer must exercise reasonable care and promptness to examine the statement and items, discover an unauthorized signature or alteration on any item, and notify the bank promptly.¹⁶⁶

2. If the customer fails in this duty¹⁶⁷ and the bank is not negligent,¹⁶⁸ the customer is precluded from claiming against the bank for any such forged or altered item and any item forged or altered by the same wrongdoer within fourteen days after the customer's receipt of the first such item.¹⁶⁹

3. Without regard to negligence by either the customer or the bank, the customer is absolutely barred from claiming against the bank after one year with respect to the customer's unauthorized signature or alteration on the face or back of the item;¹⁷⁰ and after three years with respect to any unauthorized endorsement.¹⁷¹

A customer's failure to detect forgeries or alterations by the same wrongdoer could also preclude his claim against the bank under section 3-406.¹⁷² Section 4-406(2)(b) however, would supercede section 3-406 to the extent that it imposes a fourteen day period of limitations on such recovery,¹⁷³ unless of course, the bank is shown to be negligent under section 4-406(3).

B. *When the Customer's Duties Begin*

U.C.C. section 4-406(1) provides that the customer's duties be-

166. U.C.C. § 4-406(1).

167. See *supra* § III and accompanying discussion.

168. U.C.C. § 4-406(3); see *supra* § III C and accompanying discussion.

169. U.C.C. § 4-406(2)(b).

170. U.C.C. § 4-406(4).

171. *Id.* California, Georgia, Nevada, Ohio, and Washington have varied the time periods for the reporting of forged drawers' signatures, endorsements, or alterations. See generally ANDERSON, § 4-406:3.

172. See cases cited *supra* note 117.

173. U.C.C. § 4-102(1).

come operative when the bank does any one of three things. The customer has a duty to give notice of suspected impropriety if the bank sends the statement and items to the customer; holds the statement and items for the customer; or otherwise makes the statement and items "available to the customer."¹⁷⁴

A critical question, however, concerns precisely when the period of limitation for notice to the bank begins to run. There appears to be a split of authority on the question of whether the period begins when the statement and accompanying items are placed in the mail by the bank, or when they are actually received by the customer. Anderson takes the following position:

Under the definition of the word "send" in [section] 1-201(28), the bank sends the items and statement when it puts them in the mail bearing the proper address and postage. If these documents are sent, but not delivered to the depositor, they are nevertheless "sent", and the time of the customer's investigation and report starts to run accordingly.¹⁷⁵

Anderson apparently relies upon the holding in *Kiernan v. Union Bank*,¹⁷⁶ which held that the one-year notice period "began to run from the date . . . on which the statement [was] mailed by the bank to the customer."¹⁷⁷ In this case, however, the customer was claiming that the notice period should have been tolled because his faithless employee intercepted the statement and failed to report the forged items to the employer. The result reached in *Kiernan* seems quite unreasonable and does not seem to be required by a careful reading of section 4-406. It seems unreasonable to hold a customer responsible for the time obviously required to mail the statement. Even section 1-201(38), which defines "send," provides that sending is not perfected until "the time at which it would have been received if properly sent." This implies that the customer would have a duty to inquire only if the statement and items did not arrive at the normal time.

A more reasonable interpretation of section 4-406(1) would recognize that although the customer's duties become "operative"¹⁷⁸ when the statement and items are mailed, these duties presuppose either a receipt by the customer in due course or an opportunity to inquire of the bank if the statement is not received in

174. U.C.C. § 4-406 comment 2.

175. ANDERSON, *supra* note 23, at 629.

176. 55 Cal. App. 3d 111, 127 Cal. Rptr. 441 (1976).

177. *Id.* at 444.

178. U.C.C. § 4-406 comment 2.

due course.¹⁷⁹ It should be noted that sections 4-406(2)(b) and 4-406(4), which impose absolute time limitation, do not use or incorporate the term "send." Rather, in both subsections, the respective time limits run from the time when the statement and items are "available to the customer."

The pre-section 4-406 cases were based on the theory of "account stated." Under this theory, the statement of account, though prepared and ready for delivery, does not become a stated account, with legal consequences, until it is actually placed in the hands of the party to be charged.¹⁸⁰ Expanding this idea, the better reasoned section 4-406 cases have held or inferred that the time limits provided by section 4-406 begin to run from the date that the statement and items are received by the customer. For example, it was held in *George Whalley Company v. National City Bank of Concord*:

The date on which the first item was "available" to plaintiff then determines whether plaintiff can recover for the May forgeries. Plaintiff received a bank statement and checks on approximately the third of each month. Therefore, on or about February 3, 1972, plaintiff received its January statement which included the initial forged check dated January 24, 1972. The first item, then, was "available" to plaintiff on or about February 3, 1972.¹⁸¹

This view seems even more reasonable in those states where the absolute time limits have been shortened by the legislatures.¹⁸²

C. What Constitutes Notice to the Bank

The Code does not require the customer to give any particular form of notice to the bank that checks have been forged or altered.¹⁸³ However, cases have held that such notice generally must be sufficient in content to "put the bank in a position to

179. Moreover, it has been held, in a pre-Code case, that the bank statements and cancelled checks "must go to a person authorized by the [depositor] to receive such statements". The corporate depositor had a checking account clerk, but the bank sent the statements to a person in another department; thus the requirements of the statute were not met. *York Specialties Co. v. Bank of Buffalo*, 30 A.D.2d 1044, 294 N.Y.S.2d 717 (1968).

180. *McCarty v. First Nat'l Bank of Birmingham*, 204 Ala. 424, 85 So. 2d 754, 757 (1920); *Benge v. Michigan State Bank*, 341 Mich. 441, 67 N.W.2d 721, 50 A.L.R.2d 1108, 1112 (1954); *see generally* Annot., 50 A.L.R.2d 1115 (1956).

181. *See George Whalley Co. v. National City Bank of Cleveland*, 55 Ohio App. 2d 205, 380 N.E.2d 742 (1977); *see also Hanover Ins. Co's. v. Brotherhood State Bank*, 482 F.2d 501, 504 (D.Kan., 1979); *Taylor v. Equitable Trust Co.*, 269 Md. 149, 304 A.2d 838, 845 (1973); *Hardex-Steubenville Corp., Inc. v. W. Pennsylvania Nat'l Bank*, 446 Pa. 446, 285 A.2d 874, (1972). *Cf. Winkler v. Commercial Nat'l Bank of L'Anse*, 42 Mich App. 740, 202 N.W.2d 468 (1972), where the court assumed that the 14-day period began to run "from the time that the [depositor] received the bank statement. . . ." *Id.*

182. These states are California, Nevada, Ohio, and Washington.

183. Oral notice is sufficient; *see Duralite Co. v. New Jersey Bank & Trust Co.*, 97 N.J. Super. 48, 234 A.2d 247 (1967).

make an investigation with respect to the validity of the claim of forgery. . . ."¹⁸⁴ The details of the notice may depend upon the circumstances of the loss. For example, if the forgeries have been irregular or scattered, then more particularity is required in the notice, such as "the amounts, dates and parties with respect to each check."¹⁸⁵ The notice can be more general, however, if it relates to all checks cashed or paid by the bank over a period of time.¹⁸⁶ Furthermore, the fact that the bank refuses to cash certain items not bearing authorized signatures is not considered notice to the bank that previous items from the account of the same customer were paid without authorized signatures.¹⁸⁷

D. Time Periods

1. Double forgery: 1 year or 3 years

Code section 4-406(4) gives the customer one year to report "his unauthorized signature or any alteration on the face or back of the item," and three years to report "any unauthorized endorsement."¹⁸⁸ A question arises, however, concerning which period should apply when there is a forgery of both the drawer's signature as well as the payee's endorsement.

*Bank of Thomas County v. Dekle*¹⁸⁹ was the first case to address this question, and it gave the customer an option: if the customer wanted to assert the forged drawer's signature, he had to give notice within the shorter period. On the other hand, he could "still

184. *First Nat'l Bank of Melbourne v. Sogaard and Debo, Inc.*, 406 F.2d 1128, 1131 (5th Cir. 1969); *Nationwide Homes of Raleigh, N.C., Inc. v. First Citizens Bank and Trust Co.*, 267 N.C. 528, 148 S.E.2d 693 (1966).

185. *Id.* See also *American Bldg. Maintenance Co. of California v. Federation Bank and Trust Co.*, 213 F. Supp. 412 (S.D.N.Y. 1963). Cf. *Indemnity Ins. Co. of N. Am. v. Fulton Nat'l Bank*, 108 Ga. App. 356, 113 S.E.2d 43 (1963) where the pre-Code statute required the drawer to "notify . . . [the bank] that said check bore a forged or unauthorized endorsement." The drawer's letter to the bank, stating that there were "some irregularities" in its accounts, and that certain endorsement on "various checks" had been questioned, was held to be insufficient notice. *Id.*

186. *First Nat'l Bank of Melbourne v. Sogaard and Debo, Inc.*, 406 F.2d at 1131.

187. *King of All Mfg., Inc. v. Genessee Merchants Bank and Trust Co.*, 69 Mich. App. 490, 245 N.W.2d 104 (1976).

188. These periods of limitation have been held to attach to each separate check bearing an unauthorized signature, so that "a new . . . period begins to run with each subsequent check when it is made available to the customer." The court distinguished U.C.C. § 4-406(2) where each check subsequent to the first is held to be the responsibility of the drawer-customer after fourteen days. *Neo-Tech Systems, Inc. v. Provident Bank*, 43 Ohio Misc. 31, 335 N.E.2d 395 (1974).

189. *Bank of Thomas County v. Dekle*, 119 Ga. App. 753, 168 S.E.2d 834 (1969).

rely on the forged endorsement . . . as a basis for unauthorized payment if he [gave] the notice within the applicable [three year] period.”¹⁹⁰ *Dekle* was decided before the landmark case of *Perini Corp. v. First National Bank of Habersham County*.¹⁹¹ *Perini* held that a check with both a forged drawer’s signature and a forged endorsement was to be treated as if only the drawer’s signature was forged, at least with respect to whether the drawee or depository bank should bear the loss under the “final payment” rule. Following the *Perini* rationale concerning “double forgeries,” at least two courts have held that checks bearing a forged drawer’s signature or material alteration, together with a forged endorsement, should be treated as bearing only forged drawer’s signatures of alterations for purposes of applying the one-year or three-year absolute time limitations of section 4-406(4).¹⁹² Thus, the one-year period of limitations applies to checks bearing “double forgeries.”

It is also generally recognized that checks with fewer than the required number of drawer’s signatures are to be considered as having an “unauthorized drawer’s signature” in applying the one-year period of limitation under section 4-406(4).¹⁹³ Likewise, checks showing fewer than the required number of endorsements are to be treated as having “unauthorized endorsement” for purposes of applying the three-year period of limitations.¹⁹⁴

2. Variation by agreement or statute

Some banks include in their depositor’s contracts or periodic bank statements a provision that the customer waives the right to claim for any debit not objected to within a specified period of

190. *Id.* at 838.

191. *Perini Corp. v. First Nat’l Bank of Habersham County*, 553 F.2d 398 (5th Cir. 1977); see also Baker, *The Perini Case: Double Forgery Revisited (Part II)*, 41 U.C.C. L.J. 54-56 (1978).

192. *Winkie, Inc. v. Heritage Bank of Whitefish Bay*, 99 Wis. 2d 616, 299 N.W.2d 829 (1981); *Sylvia v. Industrial Nat’l Bank of Rhode Island*, 403 A.2d 1075, 1077 (R.I. 1979); see also *Brighton, Inc. v. Colonial First Nat’l Bank*, 176 N.J. Super. 101, 422 A.2d 433 (1980), *aff’d*, N.J. Sup. Ct., Docket No. 17 (1981).

193. See *Pine Bluff Nat’l Bank v. Kesterson*, 257 Ark. 813, 520 S.W.2d 253 (1975); *King of All Mfg., Inc. v. Genessee Merchants Bank & Trust Co.*, 69 Mich. App. 490, 245 N.W.2d 104 (1976); *Neo-Tech Systems, Inc. v. Provident Bank*, 43 Ohio Misc. 31, 335 N.E.2d 395 (1974); *Rascar, Inc. v. Bank of Oregon*, 87 Wis. 2d 446, 275 N.W.2d 108 (1978). However, there is a split of authority on this point; see, *Wolfe v. Univ. Nat’l Bank*, 270 Md. 70, 310 A.2d 558 (1973); *Far West Citrus, Inc. v. Bank of America*, 91 Cal. App. 3d 913, 154 Cal. Rptr. 464 (1979); *Madison Park Bank v. Field*, 21 Ill. 583, 381 N.E.2d 1030 (1978). Professor Bailey has opined that “it would seem that the one-year time limit for reporting ought to apply in all such instances.” BAILEY, BRADY ON BANK CHECKS, 26 (1981 Cum. Supp.) [hereinafter cited as BAILEY].

194. *Trust Co. Bank v. Atlanta IBM Employees’ Fed. Credit Union*, 245 G. 262, 264 S.E.2d 202 (1980).

time. Typically, these provisions shorten or modify the time limits prescribed by section 4-406(4). Prior to the Code, the courts generally looked upon such agreements with disfavor because of the difficulty in showing assent by the customer.¹⁹⁵ The Code expressly acknowledges the validity of such agreements, the only limitation being that the bank cannot disclaim its responsibility to act in "good faith" or with "ordinary care."¹⁹⁶ Despite this limitation, the parties may "by agreement" determine the standards by which such responsibility is to be measured, if such standards are not "manifestly unreasonable."¹⁹⁷

Thus, a disclaimer which completely absolves the bank of responsibility for detecting forgeries or alterations would probably be struck down as "manifestly unreasonable."¹⁹⁸ However, pre-Code law would probably be given effect to the extent that a bank rule requiring notice of an alteration within a limited period of time can be given effect, if, a.) it is called to the depositor's attention, and b.) the depositor assents to the limitation.¹⁹⁹ However, this bank rule could not excuse the bank's negligence in paying a forged or altered check.²⁰⁰

Several states still have "Final Adjustment of Statement of Account" statutes²⁰¹ which establish a time limit after which the customer may not question the correctness of his statement. Such a provision would bar a customer's claim for a forged or altered check if the time limit had elapsed and was shorter than the absolute time limits provided in section 4-406.²⁰² In fact, a five-day statutory limitation was upheld in a case against a claim that it was both inconsistent with the section 4-406(4) one-year period

195. See BAILEY, *supra* note 193, at § 26.11.

196. U.C.C. § 4-103(1).

197. *Id.*

198. See, e.g., *State ex rel. Gabalae v. Firestone Bank*, 46 Ohio App. 2d 124, 346 N.E.2d 326 (1975), refusing to give effect to a bank imposed ten-day period of limitations.

199. See BAILEY, *supra* note 193, at § 26.11.

200. See *New York Creditmen's Adjustment Bureau, Inc. v. Mfrs. Hanover Trust Co.*, 41 A.D.2d 914, 343 N.Y.S.2d 538 (1973), where an agreement between the depositor and drawee bank, which provided that the depositor agree to report forgeries within a time period shorter than the time requirement of U.C.C. § 4-406, was held to be enforceable. An agreement which merely shortens the period for reporting does not, *per se*, absolve the bank from its negligence or obligation to act in "good faith" under U.C.C. § 4-103(1).

201. See PATON, *PATON'S DIGEST OF LEGAL OPINIONS* § 8:5 (Supp. 1980) (containing a list of states having such statutes).

202. See BAILEY, *supra* note 193, at § 26.19.

and "unduly harsh."²⁰³ The Fifth Circuit Court of Appeals sympathetically replied that "although we may question the equities of a five-day notice requirement, we cannot assume a legislative role and deny the statute's validity."²⁰⁴

3. Absolute time limits: not statutes of limitation

The one-year and three-year periods of limitation provided by section 4-406(4) are not regarded as "statutes of limitation;" rather, they terminate substantive rights and, therefore, cannot be tolled.²⁰⁵ However, when a bank sends statements and cancelled checks to a customer, this may have the effect of triggering an applicable statute of limitations.²⁰⁶

4. Actions based on common law theories

U.C.C. section 4-406(4) states that "without regard to care or lack of care of either the customer or the bank," a customer who does not notify the bank of forged signatures or alterations within the requisite time periods "is precluded from asserting against the bank" such forged signatures or alterations. Most certainly, these time limits are applicable to the bank's liability to the customer under the Code; but questions arise concerning the applicability of common law actions such as breach of contract, conversion or negligence.

In *Sun'n Sand, Inc. v. United California Bank*,²⁰⁷ the Supreme Court of California allowed a drawer to sue a depository bank on a common law negligence theory for cashing certain altered checks. The bank raised section 4-406(4) as a defense, since the altered checks had been returned to the drawer more than one year prior to notice to the bank. The court, however, rejected the defense, holding: "Subdivision (4) of section 2-206 applies only to actions based on warranties set forth in California Uniform Commercial Code. We think it clear that the rules set forth in section 406 are not intended to apply to negligence actions."²⁰⁸

Similarly, in *Kraftsman Container Corp. v. United Counties*

203. *First Nat'l City Bank v. Compania De Aquaceros*, 398 F.2d 779 (5th Cir. 1968).

204. *Id.* at 783.

205. *See Indiana Nat'l Corp. v. FACO, Inc.*, 400 N.E.2d 202 (Ind. App. 1980); *Billings v. East River Savings Bank*, 33 A.D.2d 997, 307 N.Y.S.2d 606 (1970). However, one court, reading U.C.C. § 4-406(4) *in pari materia* with U.C.C. § 4-406(5), found that the absolute bar periods "may be waived by a payor bank by failure to assert same". *Stouffer v. Oakwood Bank*, 19 Ohio App. 2d 68, 249 N.E.2d 848, 852 (1969).

206. *Kiernan v. Union Bank*, 55 Cal. App. 3d 111, 127 Cal. Rptr. 441 (1976).

207. 21 Cal. 3d 671, 582 P.2d 920, 148 Cal. Rptr. 329 (1978).

208. *Id.* at 699, 582 P.2d at 939, 148 Cal. Rptr. at 348.

Trust Co.,²⁰⁹ a depositor brought suit against the drawee bank for cashing checks without the required endorsements. The court noted that the time bar provisions of section 4-406(4) did not apply since the customer's action was essentially based "upon the bank's failure to act reasonably to protect its customer's interests,"²¹⁰ *i.e.*, breach of contract.

However, both the *Sun'n Sand* and *Kraftsman* decisions were criticized and distinguished in a New Jersey Superior Court decision.²¹¹ In *Brighton, Inc. v. Colonial First National Bank*, the drawers claimed that they could avoid the section 4-406(4) time limitations by "couching their claim based on forged signatures in different terms, *viz.* negligence, conversion, money had and received and breach of contract."²¹² The Court rejected these claims, noting that without regard to the *theory* of liability, the *facts* of liability were based on the bank's payment of an item not otherwise properly payable. Consequently, the Court held that any claim based on such facts, without regard to the theory of liability, is subject to the time period limitations of section 4-406(4).

VI. CONCLUSION

A bank, when presented with a check forgery or alteration claim, must first determine where it fits in the pattern of rights and obligations under Articles 3 and 4 of the Uniform Commercial Code. This position will be determined by the nature of the defalcation; for example, a forged drawer's signature or endorsement, a material alteration, or a combination of these.

Second, the bank will look to the array of potential defenses to the check forgery or alteration claim. The availability of particular defenses provided by Articles 3 and 4 will also be largely determined by the bank's position in the Code's pattern of rights and obligations. Frequently, the bank will find that the claimant's negligence may have contributed to the forgery or alteration (U.C.C. section 3-406) or that the claimant was derelict in giving notice of the deed to the drawee bank (U.C.C. section 4-406). It is possible that both these defenses will be available.

Although the bank both determines its rights and obligations

209. 169 N.J. 488, 404 A.2d 1288 (1979).

210. *Id.* at 490 n.2, 404 A.2d at 1290, n.2.

211. *Brighton, Inc. v. Colonial First Nat'l Bank*, 176 N.J. 101, 422 A.2d 433, *aff'd*, N.J. Sup. Ct., Docket No. 17, 870 (1981).

212. *Id.* at 105, 422 A.2d at 437-38.

and takes inventory of potential Code defenses, its legal analysis is not yet complete. The reason for the uncertainty lies in the Code's failure to achieve one of its chief objectives: "Uniformity throughout American Jurisdictions."²¹³ If this article has demonstrated nothing else, it has shown that the bank's rights, obligations, and potential defenses to check forgery or alteration claims are by no means certain; nor are they uniform among the states and federal jurisdictions. Moreover, because Articles 3 and 4 of the Code are difficult to master, judges sometimes make bad law.²¹⁴ While these difficulties cause consternation among bankers, they allow for great creativity by bankers' counsel. No claim or defense to check forgery or alteration claims should be dismissed simply because it cannot be found under a specific Code section or in a reported decision.²¹⁵ To do so may not only be a disservice to one's client; it may be a dereliction of duty.

Notwithstanding bankers' consternation or opportunities for creativity by counsel, the twin objectives of uniformity of the law and predictability of judicial decision are not being served. A thorough review of Articles 3 and 4 should be undertaken so that stability in this troublesome area of the law may be achieved.

213. General Comment of National Conference of Commissioners on Uniform State Laws and the American Law Institute, 1972 Official Text, p. IX. *See also* U.C.C. § 1-102(2)(c).

214. *See e.g.*, the holding of the Pennsylvania Supreme Court in *National Bank & Trust Co. of Central Pennsylvania v. Commonwealth*, 9 Commw. of Pa. 358, 361, 305 A.2d 769, 772 (1973), as to the meaning of negligence in 3-406; the court subsequently reversed itself in 364 A.2d 1331, 1335 (1976).

215. Consider, *e.g.*, *Girard Bank v. Mount Holly State Bank*, 474 F. Supp. 1225 (D.C.N.J. 1979), holding that the depository bank may have a common law cause of action against the negligent drawer. The case was called "precedent-shattering" by Prof. Bailey, *supra* note 193 at § 23.11. *See also* *Sun'n Sand, In. v. United Cal. Bank*, 21 Cal. 3d 671, 582 P.2d 920 (1978), which allowed a drawer to base its claim on the depository bank's allowed common law negligence in the face of U.C.C. § 4-406(4), which would bar a claim "without regard to care or lack of care of either the customer or the bank."